

STATE OF IOWA

**INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

JUNE 30, 2015

State of Iowa

Officials

Name

Title

Executive Branch

Honorable Terry E. Branstad

Governor

David Roederer

Director, Department of Management

Legislative Branch

Pam Jochum

President of the Senate

Kraig M. Paulsen (through Jan 10, 2016)

Speaker of the House of Representatives

Linda L. Upmeyer (effective Jan 11, 2016)

Speaker of the House of Representatives

Glen P. Dickinson

Director, Legislative Services Agency

Judicial Branch

Mark S. Cady

Chief Justice of the Supreme Court



OFFICE OF AUDITOR OF STATE STATE OF IOWA

Mary Mosiman, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Governor and Members of the General Assembly:

We have audited in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the State of Iowa as of and for the year ended June 30, 2015, and the related Notes to Financial Statements, which collectively comprise the State of Iowa's basic financial statements, and have issued our report thereon dated December 14, 2015. Our report includes a reference to other auditors who audited the financial statements of the Tobacco Settlement Authority, the Iowa Finance Authority, the University of Iowa Foundation, the Iowa State University Foundation, the University of Northern Iowa Foundation, the University of Iowa Research Foundation and the University of Iowa Health System and Subsidiaries, as described in our report on the State of Iowa's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the University of Iowa Foundation, the Iowa State University Foundation, the University of Northern Iowa Foundation and the University of Iowa Health System and Subsidiaries were not audited in accordance with Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Iowa's internal control over financial reporting to determine the audit procedures appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Iowa's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Iowa's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a deficiency in internal control we consider to be a material weakness and other deficiencies we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility a material misstatement of the State of Iowa's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings as item (A) to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control which is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings as items (B), (C) and (D) to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Iowa's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under Government Auditing Standards.

We noted certain immaterial instances of non-compliance or other matters which will be reported to management in separate reports.


The State of Iowa's Responses to the Findings

The State of Iowa's responses to the findings identified in our audit are described in the accompanying Schedule of Findings. The State of Iowa's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing and not to provide an opinion on the effectiveness of the State of Iowa's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the State's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.


MARY MOSIMAN, CPA
Auditor of State


WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

December 14, 2015

Findings Related to the Financial Statements:

INTERNAL CONTROL DEFICIENCIES:

(A) Unemployment Benefits Fund – To comply with governmental accounting and financial reporting standards for the Unemployment Benefits Fund, the Iowa Department of Workforce Development (IWD) has developed the MYIOWAUI system to track employer unemployment insurance contributions based on quarterly employer payroll reports. The system generates information regarding the balance of employer contributions receivable and delinquent accounts, including penalty and interest calculations, for financial reporting purposes. This activity is reported to the Iowa Department of Administrative Services – State Accounting Enterprise (DAS-SAE) in a GAAP package. The following were noted for the year ended June 30, 2015:

- (1) IWD understated accounts receivable by \$14,085,897 and understated the allowance for doubtful accounts by \$2,776,637 on the GAAP package Unemployment Benefits Fund page. As a result, the net accounts receivable balance was understated by \$11,309,260. This was properly adjusted for reporting purposes.
- (2) IWD overstated accounts payable by \$2,429,611 on the GAAP package Unemployment Benefits Fund page. This was properly adjusted for reporting purposes.
- (3) According to IWD, an account goes to non-collectible status when the most recent debt creation date on the account is older than 720 days and the last payment was not received within 90 days. These accounts should be written off for reporting purposes and not be included in the balance reported in the GAAP package. During testing, \$226,062 of \$41,143,963 of contributions, \$147,246 of \$14,204,936 of interest and \$39,422 of \$2,200,717 of penalties older than 720 days were included in the accounts receivable balance reported in the GAAP package.

Recommendation – IWD should ensure financial information generated for the GAAP package is properly reviewed for accuracy. IWD should continue to modify the MYIOWAUI system to ensure the data is accurate, timely and conforms to established policy.

Response – For numbers (1) and (2), IWD will review reconciling pages to ensure numbers are accurate on the Unemployment Benefits Fund page in the GAAP package. For number (3), the discrepancy is caused from the comparison of the Employer Accounts Receivable created from the MYIOWAUI system and the Non-Collection List. The problem lies where uncollected debt is never removed from the MYIOWAUI system so uncollected debt older than 720 days appears on this report, but is removed from the Non-Collection List. The reason the debt is not taken out of the MYIOWAUI system is because there are times we consider the debt uncollectible; however, we do receive payment on this at a later date. If there is no way to correct this in the system a comparison between the two reports will need to be done before the accountant completes this portion of the GAAP package and then back those accounts which appear older than 720 days out of the calculation.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

- (B) Financial Reporting – Departments record receipts and disbursements in the Integrated Information for Iowa (I/3) system throughout the year, including the accrual period. Activity not recorded in the I/3 system is reported to the Iowa Department of Administrative Services – State Accounting Enterprise (DAS–SAE) in a GAAP package. The GAAP package is to be submitted to DAS–SAE by the first week of September each year. Findings were noted for the following departments:

(1) Iowa Department of Administrative Services

Accounts payable for capital projects were overstated by \$263,863.

Recommendation – The Department should ensure the GAAP package information reported is complete and accurate.

Response – The Department received and paid several fiscal year 2015 invoices related to infrastructure projects in the final days of August. For infrastructure projects, DAS reports outstanding information for both invoices and retainage. Retainage information is rolled up and added to the accounts payable section of the GAAP package. Several of the end-of-year payments also included final retainage which we did not realize because of the roll up information in the GAAP package. We will no longer roll up the retainage information, but instead, list each individual project and amount. This will enable us to see the details and make accurate last minute changes to the information being reported. We will also work with vendors to encourage them to submit invoices for work completed prior to June 30th more timely.

Conclusion – Response accepted.

(2) Office of the Chief Information Officer

- (a) Amounts due from the General Fund to the Internal Service Fund at June 30, 2015 were understated by \$141,882.
- (b) Operating lease rental expense was overstated by \$67,196.

Recommendation – The Office should ensure the GAAP package information reported is complete and accurate.

Response –

- (a) The fiscal year 2015 reimbursement was processed on August 26th and coded to fiscal year 2016 even though the fiscal year 2015 hold open period was not closed. We will review fiscal year and hold open coding requirements and pre-audit responsibilities with all Chief Financial Officers (CFO's) and the Accountant 4.
- (b) The vendor's invoice for annual maintenance charges was incorrectly added to the lease database causing the overstatement. Beginning July 1, 2015, annual maintenance expenses are being identified and tracked in a separate spreadsheet.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

(3) Iowa Department of Commerce

- (a) The Department's construction obligations included in the GAAP package were overstated by \$1,812,712. This was properly adjusted for reporting purposes.
- (b) The Department overstated future minimum rental payments for operating leases by \$500,112. This was properly adjusted for reporting purposes.

Recommendation – The Department should ensure the GAAP package information reported is complete and accurate.

Response – The Comptroller and Accountant II received advice from DAS-SAE regarding the appropriate way to account for obligated costs incurred by the Division for construction contracts and improvements within the fiscal year 2015 GAAP package. The GAAP package submitted by the Division was reviewed by DAS-SAE and was later reviewed by staff of the Office of Auditor of State (AOS). In September 2015, the Division was notified by the auditors that revisions were to be made to the GAAP package. These revisions have been completed in accordance with the auditor's findings. The Division will work with DAS-SAE and the AOS on future GAAP reporting issues and questions to ensure accurate and complete data is submitted.

Conclusion – Response accepted.

(4) Iowa Economic Development Authority

The Authority overstated contractual commitments by \$1,410,062. This was properly adjusted for reporting purposes.

Recommendation – The Authority should ensure the information reported is complete and accurate.

Response - The Authority will improve both the calculation and subsequent review of information reported to ensure information is correct.

Conclusion – Response accepted.

(5) Iowa Judicial Branch

One contract paid in fiscal year 2015 included eleven months of service for fiscal year 2016, resulting in an understatement of prepaid expense of \$420,981. This was properly adjusted for reporting purposes.

Recommendation – The Judicial Branch should ensure the GAAP package information reported is complete and accurate.

Response – We reviewed our processing of prepaid expenses and will ensure the GAAP package information is complete and accurate.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

(6) Iowa Department of Transportation

The Department incorrectly recorded fiscal year 2015 accrual activity in the I/3 system as fiscal year 2016 activity, resulting in an understatement of accounts payable of \$1,392,128 for fiscal year 2015. The payable was not reported in the Department's GAAP package. This was properly adjusted for reporting purposes.

Recommendation – The Department should implement procedures to ensure all payables are identified and recorded to the proper fiscal year.

Response – The Department has implemented procedures to ensure payables are properly identified. Discussions between Accounting and Purchasing sections have identified ways for improvement in tracking fiscal years for the future, especially as they relate to capital assets. Additional information regarding fiscal year coding will be included in the year-end financial memo sent to business units. Discussions will also be held with business units providing education on proper fiscal year coding.

Conclusion – Response accepted.

- (C) Capital Assets – Chapter 7A.30 of the Code of Iowa requires each department of the state to maintain a written, detailed and up-to-date inventory of property under its charge and control. Findings were noted for the following departments:

(1) Office of the Chief Information Officer

Accumulated depreciation was understated by \$329,236 due to depreciation not recorded after a manual entry transferred assets from the Department of Administrative Services – Information Technology Enterprise (DAS-ITE) to the newly-formed Office of the Chief Information Officer (OCIO).

Recommendation – The Office should ensure a detailed, up-to-date capital asset listing is maintained. Accumulated depreciation should be properly calculated and recorded.

Response – The process of moving assets from DAS to OCIO in the I/3 fixed asset system involved multiple steps and calculations at a point in time. This was one of many activities DAS and OCIO were diligently working through, to create a new department, something which is rarely undertaken in state government and for which an implementation plan had to be created and managed. Existing controls were not all designed to accommodate the types of accounting and financial activities required to transition DAS-ITE to OCIO. The I/3 fixed asset documents were not completed timely and calculations were not adjusted for this delay. This caused a gap in the systems depreciation and an understatement in the accumulated depreciation. A one-time catch-up entry was completed in fiscal year 2016 to bring the depreciation in line.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

(2) Iowa Department of Commerce

- (a) The Alcoholic Beverages Division did not complete a reconciliation between the I/3 system and the Division's capital asset listing. In addition, the capital asset listing was not updated throughout the year, causing capital assets to be understated by \$69,653 and accumulated depreciation to be overstated by \$7,601.
- (b) Construction in progress was overstated by \$2,436,347. This was properly adjusted for reporting purposes.
- (c) Intangible assets were overstated by \$738,721. This was properly adjusted for reporting purposes.

Recommendation – The Department should ensure a detailed, up-to-date capital asset listing is maintained. Capital assets and accumulated depreciation should be properly calculated and recorded.

Response – The Division's current asset listing will be reviewed on a yearly basis by the Chief Operating Officer, Comptroller and the Accountant II. Should revisions need to be made to the asset listing, the Comptroller will review the asset listing and make the necessary adjustments. The Division will also explore the application of the I/3 asset listing to the Division's operations. Should the I/3 asset listing module prove sufficient for the needs of the Division, the current asset listing will be migrated into the I/3 system. This will provide the Division with a consolidated listing, as well as the ability to reconcile all assets within the I/3 system.

Conclusion – Response accepted.

(3) Iowa Department of Public Health

- (a) The Department maintained a list of assets disposed of on a calendar year basis. However, the listing did not contain the dates of disposal, making it difficult to determine fiscal year cut-off for testing purposes. There was no evidence of approval for two of five assets disposed of tested. In addition, one asset still in use was improperly recorded as a disposal. This was properly adjusted for reporting purposes.
- (b) Two of twelve assets selected to review the capital asset listing for completeness were not on the Department's listing.
- (c) The asset listing for the Bioterrorism program is not maintained on a current basis. The capital asset listing does not contain identifying information such as state tag I.D., serial and model number. Depreciation on assets is calculated on a yearly basis rather than being based on the month of acquisition. In addition, two of the twenty-eight additions tested were below the capitalization threshold and were incorrectly capitalized. The assets capitalized in error were properly adjusted for reporting purposes.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

Recommendation – The Department should develop written procedures to ensure a detailed, up-to-date capital asset listing is maintained. The listing should include identifying information for each asset, including state tag I.D., serial and model number. Assets should be depreciated beginning with the month of acquisition. A listing of assets disposed of should be maintained and document the dates of disposal. An independent person should review and approve disposals and approval should be documented by the reviewer's signature and date of review on the disposal listing. In addition, the Department should ensure capital assets are capitalized in the correct amounts and in the proper fiscal year.

Response – The Department will revise the guidelines for annual equipment inventory to incorporate specific guidance for purchasing, reporting and disposition of assets. An asset listing form will be developed to provide documentation of required information. The guidelines and form will be disseminated to Department personnel for use throughout the year.

Conclusion – Response accepted.

(4) Iowa Department of Transportation

The DAS-SAE policy for capitalization of internally generated software requires software modifications which exceed \$500,000 to be capitalized as intangible assets. The Department initially capitalized individual enhancements going back several years which cumulatively amounted to more than \$500,000. However, many of the enhancements did not constitute a modification for capitalization purposes. For this reason, intangible capital assets were overstated by \$3,218,537. This was properly adjusted for reporting purposes.

Recommendation – The Department should ensure intangible capital assets are correctly reported.

Response – Intangible capital assets were capitalized based on the Department's understanding of the DAS-SAE, GASB 51 Implementation – Intangible Assets policy. The Department made a good faith effort to report all intangible assets currently in use which exceeded \$500,000, based on our interpretation of the policy. After the GAAP package was completed, staff from the Office of Auditor of State provided additional clarification on the definition of enhancement costs and thresholds which should be used. Intangible capital assets will be reported according to this revised understanding of the guideline in future years.

Conclusion – Response accepted.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

- (D) Payroll – Departments process and record payroll and personnel information in the Human Resource Information System (HRIS). The Human Resource Associates utilize an online P-1 document to initiate and approve payroll actions, such as adding new employees and recording pay raises. Findings were noted for the following departments where there were no compensating controls:

(1) Iowa Department of Education

Twenty-seven individuals within the Department have the ability to initiate and approve timesheets.

Recommendation – To strengthen controls, the Department should develop and implement procedures to segregate the duties of the Human Resource Associates from the duties of payroll.

Response – We certainly understand the concern and the rationale behind the recommendation. In practical terms, this will be very difficult for us to implement due to staffing levels. We have developed a process where no one person can put all levels of approval on anything in HRIS. We believe this process gets us to the same result as the above recommendation.

Conclusion – Response accepted.

(2) Iowa Department of Natural Resources

Three individuals have the ability to apply multiple levels of approval to timesheets. These three individuals also have the ability to initiate and approve P-1 documents.

Also, one individual receives the preliminary payroll report, makes changes and reviews the final report. However, the preliminary payroll report is not maintained and there is no independent review to ensure the final adjusted payroll report is correct.

In addition, four of ten timesheets tested were approved by a supervisor on or after the payroll warrant date and two of ten timesheets tested were not approved by a supervisor.

Recommendation – To strengthen controls, the Department should develop and implement procedures to further segregate duties so individuals do not have the ability to apply multiple levels of approval to timesheets. The Department should obtain a listing from the Department of Administrative Services to verify Department approvals of P-1 documents are being applied appropriately. This report should be independently reviewed by the Bureau Chief or designee.

Also, the individual certifying the final payroll reports should periodically choose individual items from the payroll reports to review for accuracy and documentation of changes and the preliminary report should be kept with the final payroll report.

In addition, the Department should develop procedures to ensure all timesheets are approved timely.

State of Iowa

Schedule of Findings

Year ended June 30, 2015

Response – The Department makes every effort to ensure accurate time reporting. Beginning in fiscal year 2016, the Department requested a P-1 report quarterly from the Department of Administrative Services. This report is formatted upon receipt to determine which P-1's are initiated and approved by the same individual. These P-1's are then reviewed for reasonableness and necessity by the Human Resource Supervisor or his designee. The Department will also periodically perform an independent review of final payroll journals to approved timesheets.

In addition, the Department plans to eliminate the use of paper timesheets by April 2016. The shift from bubble sheets (paper timesheets) to the Time and Activity reporting system – TARS, will increase the accuracy of time reporting, and allow timely supervisor approval.

Conclusion – Response accepted.

INSTANCES OF NON-COMPLIANCE:

No matters were noted.